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TAGS: [ECON](#) [EFIN](#) [HK](#)
SUBJECT: HKMA LAUNCHES STRATEGIC PORTFOLIO

11. (U) Summary: Hong Kong Chief Executive Donald Tsang, in his annual policy speech October 10, announced that one of his priorities during his current term would be to review the government's role in the management of its share assets with an eye toward achieving higher returns and improving governance. On the heels of the Hong Kong government's surprise acquisition of 5.88% of the Hong Kong stock exchange, events suggest Hong Kong is moving to establish its own small but actively managed sovereign wealth fund that may target strategic, rather than profit maximizing, investments. Hong Kong Monetary Authority (HKMA) senior officials confirm the HKMA will begin actively managing a small portion of its reserve fund, with investments focusing on alternative investment vehicles. End Summary.

12. (SBU) Comment: HKMA officials have been skeptical of plans for the International Monetary Fund to issue best practices guidelines for sovereign wealth funds, arguing such funds are insignificant in global financial flows when compared to non-transparent and "under-regulated" hedge funds. Although HKMA has a very strong record of transparency and openness, recent moves suggest the government is beginning to see strategic value in closer management of its reserves and may be keen to avoid IMF-proposed guidelines. While we do not expect Hong Kong to be a large strategic investor abroad, HKMA investments in local entities may warrant additional scrutiny. End Comment.

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HK's Closer Integration with China
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13. (U) CE Tsang's annual policy speech outlined several financial policies to strengthen financial market linkages and promote the government's goal of closer integration with the Mainland economy, including: promoting the Qualified Domestic Institutional Investor (QDII) scheme, encouraging renminbi (RMB) denominated transactions, improving cooperation with Mainland financial authorities, and development of an Islamic bond market. In addition, Tsang vowed to enhance the efficiency of management of government assets to achieve higher returns and improve governance.

14. (U) This vow, combined with the recent purchase by the HKG of 5.88 percent of the Hong Kong Exchanges and Clearing Limited (HKEx), signifies a new investment posture for the HKMA. Previously, HKMA reserves (known as the Exchange Fund) had been divided into two portfolios: the Backing Portfolio, required by law to provide full US-dollar backing for the Hong Kong monetary base; and the Investment Portfolio, which was in turn divided into fixed assets, primarily U.S. Treasuries, and equities. The equity portion of the

portfolio (approximately 23% of the total Exchange Fund) is contracted out to a number of professional fund managers to invest globally according to guidance provided by the Exchange Fund Advisory Committee (EFAC).

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HKMA's New Strategic Portfolio

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15. (U) HKMA Chief Executive Joseph Yam announced to the Legislative Council on November 8 that HKMA had created a new third portfolio in the Exchange Fund, called the Strategic Portfolio. The Strategic Portfolio currently holds only shares of HKEx, purchased in previous years for investment purposes and recently for strategic purposes by the Financial Secretary using the Exchange Fund. Profits or losses from

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the Strategic Portfolio will reportedly not be included in HKMA's normal accounting reports.

16. (SBU) In addition, HKMA Executive Director for Research Hans Genburg told Consulate officials that the HKMA Board has agreed to set aside a small part of the Exchange Fund that will be managed independently of the main body of the fund. This special fund is envisioned to not exceed 5% of total reserves. This special fund will be managed by the reserve management department and will be invested in alternative investment vehicles, much like other Sovereign Wealth Funds, said Genburg.

17. (U) Through nine months of 2007, the Exchange Fund has already made record profits of over HKD 114 billion (US\$14.7 billion), easily surpassing the record of HKD 103.8 billion in 1999 and HKD 103.7 billion in 2006. Yam cautioned that the year was not yet over and given the high degree of

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volatility in the Hong Kong share market, there was room for backsliding. Still, with 23% of the Exchange Fund invested in global equities, the prospects for a record year are good, even if Hong Kong stocks fall dramatically in the fourth quarter. Hong Kong's total reserves stood at US\$ 140.85 billion at the end of September, including HKD 377.7 billion (US\$ 48.75 billion) in fiscal reserves.
Cunningham